

DEPARTMENT OF THE AIR FORCE  
WASHINGTON

OFFICE OF THE SECRETARY

Dear Mr. Speaker:

There is forwarded herewith a draft of legislation "To amend section 2306 of title 10, United States Code, to authorize certain contracts for supplies and services to extend beyond one year".

This proposal is a part of the Department of Defense Legislative Program for the 89th Congress and the Bureau of the Budget advises that, from the standpoint of the Administration's program, there is no objection to the presentation of this proposal for the consideration of the Congress. The Department of the Air Force has been designated as the representative of the Department of Defense for this legislation. It is recommended that this proposal be enacted by the Congress.

Purpose of the Legislation

The purpose of this legislation is to amend section 2306 of title 10, United States Code, to authorize contracts for supplies and services funded by annual appropriations for periods in excess of one year, under specified circumstances.

Certain supplies and services now being procured each fiscal year with funds appropriated annually require substantial investment by the contractor in equipment with a useful life extending beyond one year, or require extensive investment in the hiring and training of personnel. In either case, the investment cannot be economically written off by the contractor as the expenses of a single year. Nevertheless, if a contractor is operating on a one-year contract, he must either write off all his expenses in the first year of operations or take the risk of never recovering his unamortized investment if he loses the contract for the ensuing year or years. This dilemma tends to discourage contractors from bidding on such procurements, thereby reducing the field of competition and tending to raise prices.

This problem is not a new one, and it was pointed up by the decision of the Comptroller General in the Wake Island case (B-144641, November 30, 1962). The Air Force attempted to obtain the benefits of a multi-year procurement using fiscal-year money, without running afoul of the appropriations statutes. A three-year requirements-type contract was awarded

after formal advertising, obligating the contractor to furnish all labor, equipment, materials and supplies for servicing Government aircraft at Wake Island, when required, for billeting of military and civilian Government personnel, passengers and crews, and for performing other related services of Air Base management. It was estimated that the contract for the full three years would total approximately \$6.2 million, to be paid out of fiscal year money but that "calls" for services and supplies would be placed from time to time supported by then current fiscal year funds. Since no calls could be made in any given year in the absence of available funds for that year, the Air Force considered that no obligation in advance of or in the absence of the appropriation of funds was incurred.

Sometime after award, the Comptroller General questioned the basis for this three-year award using fiscal year money. The award was not upset, but the Comptroller General ruled that the contract was in fact a violation of 41 U.S.C. 11. Recognizing the procurement problems inherent in his decision, the Comptroller General nevertheless indicated that only Congressional action would be effective to carry out multi-year procurement in the Wake Island situation.

The Wake Island case is illustrative of the difficulties faced by the military departments in certain procurements. In Wake Island, extensive machinery and equipment, as well as personnel, had to be transported to a remote area at considerable expense to the contractor. If the contractor were required to rely exclusively on a one-year contract, his contract price would have to cover all these expenses. However, once having been awarded the contract, in subsequent years he would be in a position to underbid any competitors, who would be obliged to include in their bid prices their initial costs of obtaining and transporting equipment and personnel. As a result of the initial one-year contract, competition would thereafter be reduced, and the Government might be overcharged in subsequent years. The other alternative of prospective bidders -- "buying in" by offering a price lower than expected costs in an attempt to recover losses in follow-on contracts -- is undesirable both to prospective bidders and to the Government. Competition should be based upon sound business considerations, not upon speculations as to future contracts.

If three or five-year contracts could be awarded instead, contractors could spread initial costs over the entire contract term and provide the Government sustained quality performance from year to year. In similar procurements not limited by dependence upon annual appropriations, multi-year contracts have effected cost savings both in contract price and in the cost of contract administration. In Fiscal Year 1964, for example, the Air Force advertised a five-year requirement for certain weather measuring instruments. A low unit price of \$76.70 was bid for

the first year's requirement of 17,075 units. On a five-year basis for 83,315 units, however, the bid of the lowest bidder was \$2.39 lower per unit than the single year low bid. Since no-year funds were used, the Air Force was able to award the five-year contract to Monmouth Electric Company at a saving of \$199,122 out of a total award price of \$6,191,137. Had the contract been funded with fiscal year money, present law would have prohibited the five-year award.

In another case the Army advertised two years' requirements for PRC-25 and RT-505 radio sets. The lowest prices quoted for the combined requirement were \$604.05 each (PRC-25) and \$561.50 each (RT-505). These were lower than prices quoted on an alternate bid for one year only by \$37.63 each (PRC-25) and \$36.17 each (RT-505). This reflected a net savings of \$747,522.12. The contract award totalled \$12,680,533. Prices paid on the previous (FY 63) procurement for comparable quantities were \$843.37 each (PRC-25) and \$782.10 each (RT-505). This indicates unit differentials of \$239.32 and \$220.60, respectively, compared with the multi-year prices. Applying the FY 63 prices to the total multi-year quantities, a total of \$4,721,291.84 in lower prices is indicated for combined FY 64 and 65 requirements.

There is precedent for the proposed legislation. In a case analogous to Wake Island, the Atomic Energy Commission sought to enter into a five-year contract for the purchase of magnesium. The long term of the contract was expected to enable the contractor to produce substantial savings for the Commission by constructing and utilizing a new production plant. The contractor, however, was unwilling to contract without assurance (in the form of a five-year contract with provision for termination payment) that he would recoup the cost of the plant allocable to the Commission's contract. The Comptroller General ruled the proposed contract illegal under 41 U.S.C. 11 and 31 U.S.C. 665. (B-130815, April 2, 1957, September 3, 1957). Subsequently Public Law 85-681, September 21, 1959 (42 U.S.C. 2201 (u) (2)) was enacted which authorizes the Commission to enter into five-year contracts for supplies and services requiring special facilities the amortization of which constitutes an appreciable part of the contract cost. The history of this enactment indicates that it was passed in response to the Comptroller General's decision (H.R. Rept. No. 2272, 85th Cong., 2d Sess. (1958)).

The rationale behind the Atomic Energy Commission decision and the Congressional response thereto applies with equal force to the problem of the military departments. Statutes have also been enacted in other years to meet this problem. For example, the Federal Property and Administrative Services Act of 1949 (40 U.S.C. 481 (a)(1)) gives the Administrator of General Services authority to contract up to ten years for public utility services. (See also 10 U.S.C. 2352 (five-year contracts for services and facilities for research and development);

and 10 U.S.C. 2675 (five-year leases of foreign real property)). Attempts to meet this problem without Congressional action have met with little success. Thus, single-year contracts coupled with options are relatively ineffective, since contractors are uncertain that the Government will take up the options beyond the first year. As a result, contractors must still bid to cover costs in the first year. This proposal meets the problem of Wake Island and other cases presenting similar business considerations in the same manner as Congress previously responded to the Atomic Energy Commission case and other cases. It would allow contracts up to five years where the Secretary finds that there is a continuing requirement and a need for substantial investment or extended liability, when it is in the best interests of the United States to contract on this basis.

It is contemplated that if this proposed legislation is enacted, the same funding arrangements would be established as are now applied in connection with multi-year procurement using no-year appropriations as approved by the Comptroller General. While the liability under the contract would cover periods beyond the end of the fiscal year, funds would only be obligated in any one year against the then current appropriation to cover the value of goods and services to be delivered or performed during the applicable year. In addition, funds of the current appropriation would be committed each year to cover any liability which might result should the contract be terminated at the end of that year. This would permit the Government to cancel the contract where circumstances change so as to make the product or services no longer required, or for any other reason.

In summary, three major benefits are expected to flow from the proposed legislation: cost reduction, increased competition, and improved performance.

#### Cost and Budget Data

The enactment of this legislation would result in substantial savings of appropriated funds. Wake Island and the above cases are not unique situations. Enclosure 2 sets forth certain other typical situations where multi-year procurement would result in substantial savings and other benefits to the Government. Substantial savings and increased efficiency can be achieved in a broader class of contracts, but only if the proposed amendment is passed.

Sincerely,

Attachments

Honorable John W. McCormack

Speaker of the House of Representatives

IDENTICAL LETTER FORWARDED TO PRESIDENT PRO TEMPORE OF THE SENATE